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Implications of the New EU Market Abuse Regulation for Issuers of Securities Traded on EU Regulated Markets and Unregulated Exchanges in the European Union

Background

From July 3, 2016, a new market abuse regime, comprising the EU Market Abuse Regulation (596/2014/EU) ("***MAR***"), will apply to issuers with securities listed in the European Union.[1] MAR will replace the currently applicable EU Market Abuse Directive (2003/6/EC) ("***MAD***") with an updated and strengthened framework for addressing insider dealing, other improper disclosure of inside information and market manipulation. An accompanying EU Directive on Criminal Sanctions for Market Abuse (2014/57/EU) ("***CSMAD***") will provide a new mandatory criminal sanctions regime to be applied to market abuse offenses. MAR applies directly without any further action by EU Member States, while the CSMAD is given effect by transposition under local law of the EU Member States (which, subject to certain exceptions, is to have occurred by July 3, 2016).

Unlike MAD, which applied only to issuers whose financial instruments[2] were admitted to trading on an EU regulated market, the new market abuse regime also applies to issuers whose financial instruments trade on multilateral trading facilities ("***MTF***")[3], such as Ireland's Global Exchange Market (or GEM), Luxembourg's Euro MTF Market and the UK's AIM, and organized trading facilities ("***OTF***"). This coverage represents a significant expansion in the number of issuers that will need to comply with the requirements of the MAR regime, compared with MAD. For example, issuers whose only listed securities in the European Union are listed on an MTF, including a significant number of issuers of high yield bonds, will now have to comply with the new regime. Other issuers that may generally be familiar with the market abuse obligations under MAD will now need to ensure that they comply with the revised obligations under MAR. Importantly, because of the significant expansion in the scope of MAR, companies may need to adopt procedures to comply with MAR's obligations at various levels in their corporate structure, as finance or other subsidiaries that have issued securities trading on MTFs or OTFs will now also be covered by the new regime.

As discussed more fully below, key provisions of MAR prohibit insider dealing, unlawful disclosure of inside information and market manipulation. Other provisions impose obligations on issuers in respect of disclosure of inside information and maintenance of insider lists and impose reporting obligations on certain insiders in respect of their transactions in securities of the relevant issuer.

Key Requirements of the Market Abuse Regulation

Prohibited Activities

Insider dealing

MAR prohibits insider dealing, which arises where a person possesses inside information[4] and uses (or attempts to use) that information by acquiring or disposing of financial instruments to which that information relates. Recommending that another person engage in, or inducing another person to engage in, insider dealing is prohibited as well. The person recommending or inducing insider dealing based on inside information it possesses as well as the person using such recommendation or inducement, if the latter knows or ought to know that it was based on inside information, would be engaged in prohibited insider dealing.

It can generally be deemed from the mere fact that a person is or has been in possession of inside information that that person has used such information and thus engaged in insider dealing. However, under certain circumstances,[5] the mere fact that a person possesses inside information will not automatically lead to such an assumption. For a legal person, this is the case if adequate and effective internal procedures were in place that ensured that any natural person who acted on behalf of the legal person, or may have had an influence on the decision, was not in possession of the information, and the legal person did not induce or influence the natural person acting on its behalf.

Further situations in which the mere possession of inside information does not create a presumption of insider dealing include: (i) where the transaction in question is carried out in the discharge of a contractual, legal or regulatory obligation that has become due in good faith and not to circumvent the prohibition against insider dealing, and which arose before the person possessed inside information, and (ii) where inside information was obtained in the conduct of, and used solely for the purpose of proceeding with, a public takeover or merger with a company, *provided* that at the point of approval of the merger or acceptance of the offer by the shareholders of that company, any inside information has been made public or has otherwise ceased to constitute inside information.

Unlawful disclosure of inside information

MAR provides that inside information may generally only be disclosed to another person if such disclosure is made in the normal exercise of an employment, profession or duties.[6] All other instances where inside information is disclosed will generally be presumed to constitute unlawful disclosure of inside information.

Disclosures made in the course of a "market sounding" to gauge potential investors' interest in a possible transaction and the conditions relating to it (e.g., through pilot fishing or early look meetings), however, are not unlawful so long as certain requirements are met.[7] The disclosure of inside information by a person intending to make a takeover bid or a merger is generally permitted as well.

The market soundings exception did not exist under MAD and has been added to MAR to allow issuers to gauge the opinion of potential investors, to enhance shareholder dialogue and to ensure that deals run smoothly and views of issuers, existing shareholders and potential investors are aligned, without risking violation of the prohibition on unlawful disclosure of inside information.

Market Manipulation

Market manipulation is generally prohibited under the MAR regime, which provides a comprehensive catalog of potential market manipulation scenarios. Market manipulation is, for example, defined to include any behavior (whether or not successful) which may send false or misleading signals[8] as to the supply of, demand for, or price of, a financial instrument, or which may secure the price of financial instruments. Only for this type of market manipulation an exemption may apply, according to which behavior will not constitute market manipulation if the person acting establishes that it conformed with an "*accepted market practice"* as determined by the relevant competent authority.

In assessing whether certain behavior constitutes accepted market practice, MAR lists several criteria, such as whether the market practice provides for a substantial level of transparency, whether it ensures a high degree of safeguards to the operation of market forces and the proper interplay of supply and demand, and whether it has a positive impact on market liquidity and efficiency. MAR does not permit the competent authorities to adopt as accepted market practice certain behavior, including, *among others*:

- the use of a fictitious device or any other form of deception;
- the dissemination of information through media or the internet that may lead to false or misleading signals as to the supply of, demand for, or price of, a financial instrument;
- false or misleading information in relation to a benchmark;
- any conduct to secure a dominant position over the supply of or demand for a financial instrument with the effect of fixing prices or creating unfair trading conditions; and
- the buying or selling of financial instruments at the opening or closing of the market, which is likely to have a misleading effect on investors.

Issuer Obligations

The MAR regime requires certain public ad-hoc disclosures, insider lists and notifications with respect to certain transactions by managers.

Public disclosure of inside information

Issuers have to inform the public as soon as possible of inside information directly concerning them, in a manner that enables fast access and complete, correct and timely assessment of the information by the public. To comply with this requirement, issuers should look to the EU Transparency Directive (2004/109/EC) ("***Transparency Directive***")[9] which provides that inside information should be disclosed (i) in a non-discriminatory manner, (ii) through media allowing dissemination throughout the European Union (not necessarily located in the home member state of the issuer), and (iii) in compliance with certain minimum quality standards.[10] In order to meet these requirements, issuers should use Regulatory Information Service ("***RIS***") providers.[11] The disclosure of inside information to the public has to be published and kept on an issuer's website for at least five years.

The disclosure of inside information may be delayed, if:

- immediate disclosure is likely to prejudice the legitimate interests of the issuer;
- delay of disclosure is unlikely to mislead the public; and
- the issuer is able to ensure the confidentiality of that information.

In case of a delayed disclosure the issuer has to inform the relevant competent authority that disclosure was delayed and provide a written explanation of how the aforementioned conditions were met immediately after the information is disclosed to the public.[12] Where disclosure of inside information has been delayed and the confidentiality of that inside information is no longer ensured, the issuer is obligated to disclose that inside information to the public as soon as possible.

Further rights to delay disclosure exist for issuers that are credit or financial institutions if there is a risk of undermining the financial stability of the issuer and the financial system.

Insider lists

Issuers, or any person acting on their behalf[13], are required to draw up an insider list of all persons who have access to inside information and who are working for them under a contract of employment, or otherwise performing tasks through which they have access to inside information (e.g., advisers, accountants or credit rating agencies). This list is to be updated promptly if necessary[14] and provided to the competent authority upon request. The issuer or person acting on its behalf to maintain the list is required to take all reasonable steps to ensure that all persons included on the insider list acknowledge in writing the legal and regulatory duties entailed and are aware of the sanctions applicable to insider dealing and unlawful disclosure.

The insider list has to include at least (i) the identity of any person having access to inside information, (ii) the reason for including that person in the insider list, (iii) the date and time at which that person obtained access to inside information, and (iv) the date on which the insider list was drawn up.

Managers' transactions

Persons discharging managerial responsibilities ("***PDMRs***")[15], and persons closely associated[16] with them, have to promptly (and no later than three business days after the transaction) notify the issuer and the competent authority[17] of every transaction conducted on their own account relating to the shares or debt instruments of that issuer or to derivatives or other financial instruments linked thereto. The notification requirement extends to pledging and lending of shares or debt instruments of the relevant issuer.

The notification is only required once the total amount of such transactions has reached a threshold of €5,000 within a calendar year (which may be increased by a competent authority to €20,000[18]), which shall be calculated by adding, without netting, all transactions undertaken in the relevant year. The issuer has to ensure that the notification with the required information as specified in MAR is made public promptly and, in any event, no later than three business days after the transaction requiring notification in a manner that enables fast access to this information on a non-discriminatory basis.

Issuers have to notify PDMRs of their notification obligations in writing and draw up a list of all PDMRs and persons closely associated with them. PDMRs have the obligation to notify in writing the persons closely associated with them of their obligations and must retain a copy of any such notification.

PDMRs of an issuer may generally not conduct any transactions relating to the shares or debt instruments of the issuer or to derivatives or other financial instruments linked to them during a closed period of 30 calendar days before the announcement of an interim financial report or a year-end report which the issuer is obliged to make public.[19] An issuer may, however, allow a PDMR to trade during the aforementioned closed period either on a case-by-case basis due to the existence of exceptional circumstances or due to the characteristics of the trading involved for transactions made in relation to an employee share or saving scheme, or transactions where the beneficial interest in the relevant security does not change.

Sanctions

Administrative Sanctions

EU Member States are required to ensure that market abuse offences are subject to minimum administrative sanctions, such as cease and desist orders, disgorgements of profits gained or losses avoided, public warnings indicating the persons responsible for infringement, withdrawals or suspensions of authorizations for investment firms, and temporary and permanent bans on PDMRs. MAR also sets maximum administrative pecuniary sanctions of at least three times the amount of the profits gained or losses avoided, where those can be determined. In all other cases, the maximum administrative pecuniary sanctions are set as follows:

Type of market abuse	For natural persons	For legal persons
Insider dealing; unlawful disclosure of inside information; market manipulations	€5 million	€15 million or 15% of total annual turnover
Failure to prevent and detect market abuse; failure to publicly disclose inside information	€1 million	€2 million or 2% of total annual turnover
Failure to prepare and maintain insider lists; breach of obligations regarding PDMRs' transactions	€500,000	€1 million

Criminal Sanctions (CSMAD)

While MAR deals with administrative sanctions related to market abuse, CSMAD creates a related criminal sanctions regime. Under CSMAD, all EU Member States[20] are required to introduce minimal criminal sanctions and penalties, which are "effective, proportionate and dissuasive", for intentionally committed, serious market abuse offences. CSMAD recitals provide guidance as to what factors should be taken into consideration when determining the seriousness of the offence, such as the impact on the integrity of the market, the actual or potential profit derived or loss avoid, the level of damaged caused to the market and the level of alteration of the value of the financial instrument.

Considerations for Issuers first Becoming Subject to the EU Market Abuse Regime

Issuers with securities listed on unregulated exchanges that will, for the first time, become subject to the EU market abuse regime should consider taking the following steps, *among others*, to ensure compliance with the applicable requirements:

- prepare policies and procedures for dealing with how inside information is identified, handled and disclosed (this may require the engagement of an RIS provider and the preparation of a website to disseminate the information);
- prepare policies and procedures for creating and maintaining insider lists;
- prepare policies and procedures relating to PDMRs' transactions and keeping lists of PDMRs and closely associated persons; and
- design and provide appropriate compliance and training programs to employees and PDMRs regarding their obligations in respect of insider dealing, disclosure of inside information, market manipulation, market soundings, disclosure requirements and record keeping arrangements as well as the corresponding sanctions for breach of these obligations.

Issuers subject to the EU market abuse regime for the first time should also consider how the substantive rules differ from other regimes to which they may also be subject. For example, US public companies that are issuers subject to MAR directly or that have financial or other subsidiary issuers subject to MAR should be aware of the following:

- The MAR approach to disclosure of inside information differs from the US regime governing selective disclosure of material non-public information. The US Regulation Fair Disclosure (or Regulation FD) does not create an independent obligation to disclose material non-public information; rather, it governs the circumstances, and appropriate recipients, of such disclosure. As such, it distinguishes between intentional selective disclosure of material nonpublic information (which it, in effect, prohibits) and unintentional selective disclosure of such information (which it recognizes can occur and as to which it provides a method of prompt cure).
- In contrast to the approach under MAR, US public companies will need to undertake a different analysis to determine whether they have an obligation to disclose information about material events or developments to the market. This could result, for example, in earlier disclosure in the United States than might otherwise be the case in Europe.
- The MAR regime covers a broader category of instruments than "securities," to which the U.S. insider trading regime (under Section 10(b) and Rule 10b-5 of the US Securities Exchange Act (the "**Exchange Act**")) applies. (The MAR definition of financial instruments aligns with the definition set forth in the new EU Markets in Financial Instruments Directive (generally referred

to as MiFID II).) That having been said, insider trading in the swaps and derivative markets in the United States can now be subject to enforcement action based on changes to Commodity Futures Trading Commission rules mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

- A determination that information is or is not "inside information" for purposes of MAR could differ from the determination of whether that information constitutes "material, nonpublic information" for US purposes.
- The notification obligations and close period prohibitions on trading that apply to PDMRs will differ significantly from reporting obligations or profit disgorgement rules under Section 16 of the Exchange Act (which obligations apply to directors, executive officers and to 10% holders of registered voting equity securities) or reporting obligations under Section 13(d) of the Exchange Act (which obligations apply to holders of 5% of registered voting equity securities), and may well differ from customary corporate securities trading policy restrictions based on US rules and market practice.

The text of MAR can be found here.

The text of the CSMAD can be found here.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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[1] Certain provisions of MAR have already been effective since July 2, 2014; from July 3, 2016 the full regulation will come into force in the European Union. MAR was marked as relevant for application in the European Economic Area (the "***EEA***") by the European Union and is currently being considered for application by the EEA member states of Iceland, Liechtenstein and Norway.

[2] "Financial instruments" include, *among others*, transferable securities, money-market instruments and certain options, futures, swaps, forwards and other derivatives. In addition, some MAR provisions also apply to, or stipulate specific rules for,

products not included in this definition, such as spot commodity contracts or auctioned products based on emission allowances; this alert focuses exclusively on financial instruments.

3 MAR applies to a relevant issuer from the point in time at which a request for admission to trading on a regulated market or MTF has been made by that issuer.

4 MAR defines 'inside information' as "information of a precise nature, which has not been made public, relating directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments…"

5 MAR refers to such circumstances as "*legitimate behaviour*."

6 Unless that third party is bound by duties of confidentiality, the issuer is required to (i) simultaneously disclose the inside information to the public in the case of intentional disclosure, or (ii) promptly disclose the information in the case of non-intentional disclosure.

7 Prior to conducting a market sounding, the disclosing person is obligated to consider specifically whether the market sounding will involve the disclosure of inside information and, if so, make (and update) a written record of this conclusion and its reasons. This applies to each disclosure of information throughout the course of the market sounding. Furthermore, the disclosing person is required to obtain the prior consent of the person who is to receive inside information in the proposed market sounding as to the receipt of such information and to inform such person of related duties and restrictions. The disclosing person also has to maintain and keep for at least five years a record of all information given to the market sounding recipient(s). As directed by MAR, the European Securities and Markets Authority ("***ESMA***") is in the process of finalizing technical standards as to the appropriate arrangements, procedures and recordkeeping requirements for persons to comply with the provisions of MAR as to the disclosure of inside information in market soundings.

8 Several other types of market manipulation listed in MAR also contain elements of behavior that send misleading signals to other market participants or affects prices.

9 The Transparency Directive only directly applies to EU regulated markets, but ESMAsuggests that compatible requirements should apply to MTFs/OTFs to "*reach a level playing field*." Issuers on EU regulated markets will additionally have to provide the disclosed inside information to their home Member State's officially appointed mechanism for the central storage of regulated information; ESMA considers this as not required for issuers on MTFs/OTFs.

10 The minimum quality standards are: (i) dissemination to as wide a public as possible, and as close to simultaneously as possible across EU member states (synchronization); (ii) communication in unedited full text to the concerned media; (iii) security of the communication with minimal risk of data corruption and unauthorized access, and certainty as to the source of the information; (iv) communication in a way which makes clear that the information is regulated information, identifies clearly the issuer concerned, the subject matter and the time and date of the communication; and (v) the issuer should be in position to provide upon request to the competent authority information in relation to the disclosure to the media (e.g., date and time, security information, medium of communication, etc.).

11 Such as *DPAG* (Germany) or *Business Wire Regulatory Disclosure* (United Kingdom).

[12] Competent authorities may provide that such explanation is to be provided upon request only. For example, the UK Financial Conduct Authority ("***FCA***") has already indicated that it will only require such explanation upon request.

[13] Where another person acting on behalf of the issuer assumes the task of drawing up and updating the insider list, the issuer nonetheless remains fully responsible for complying with MAR.

[14] An update is necessary in case of (i) a change in the reason for including a person already on the list, (ii) a new person who has access to inside information, and (iii) a person who ceases to have access to inside information.

[15] "PDMR" means a person within an issuer who is (i) a member of the administrative, management or supervisory body of that entity; or (ii) a senior executive who is not a member of the bodies referred to (i), who has regular access to inside information relating directly or indirectly to that entity and power to take managerial decisions affecting the future developments and business prospects of that entity.

[16] "Person closely associated" means (i) a spouse or equivalent partner; (ii) a dependent child; (iii) a relative who has shared the same household for at least one year on the date of the transaction concerned; or (iv) a legal person, trust or partnership, the managerial responsibilities of which are discharged by a person discharging managerial responsibilities or by a person referred to in (i), (ii) or (iii), which is directly or indirectly controlled by such a person, which is set up for the benefit of such a person, or the economic interests of which are substantially equivalent to those of such a person.

[17] Refers to the competent authority of the EU Member State where the issuer is registered or, if the issuer is not registered in a Member State, of the home Member State in accordance with sub-clause (i) of Article 2(1) of Directive 2004/109/EC or, in the absence thereof, of the trading venue.

[18] For example, the FCA has indicated that it will retain the €5,000 threshold but that issuers can also voluntarily report all the transactions, without regard to the set minimum, if they chose to do so.

[19] Clarification is expected from the FCA, for example, as to which financial reports (preliminary earnings announcements versus the publication of the printed annual report) are relevant for purposes of the 30-day period.

[20] The United Kingdom, Denmark and Ireland hold a special position under the Lisbon Treaty as regards EU criminal law and are not subject to it unless they opt in. While Ireland has opted in, the United Kingdom and Denmark decided not to adopt CSMAD as their national legislation already provides for criminal sanctions for market abuse. The UK Government has recently indicated that it will be introducing new domestic criminal offences for market abuse.